Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554



In the Matter of: )
)
Implementation of the Local Competition ) CC Docket No. 96-98
Provisions in the Telecommunications )
Act of 1996 )





Comments of the Competition Policy Institute



May 16, 1996

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## Summary of Comments

The Competition Policy Institute (CPI) supports an aggressive strategy by the Commission and the States to implement local exchange competition. We believe that consumers' interest is best served by a quick transition to local competition. The promise of the 1996 Act will not be delivered until all consumers have competitive choices.

The Commission should adopt rules to decide the most fundamental issues in the implementation of §251 and §252 of the 1996 Act. Specifically, the Commission should set a national policy framework for the availability and pricing of unbundled network elements, interconnection and resale. States, in their role as arbitrators in negotiations among new entrants and incumbent LEC's, should apply these national principles to reach results in each case.

Successful implementation of the 1996 Act will require the close cooperation between federal and state regulators. CPI favors an implementation plan which maximizes the role of the FCC and States jointly.

The Commission should adopt a minimum set of unbundled network elements which States may expand. The burden to show that access to a specific element is not feasible should be placed on the LEC providing the element.

The price of unbundled network elements should be set on the basis of Total Service Long Run Incremental Costs (TSLRIC) and should include a loading of overhead expenses which would be incurred by an efficient firm. The price of network elements should also include a reasonable allocation of joint and common costs incurred to provide the element. When the TSLRIC methodology is applied to network elements, the joint and common costs are not large.

The Commission should specify in rules a minimum set of points of interconnection which the States may expand. For traffic termination, the rules should specify the use of Total Service Long Run Incremental Costs (TSLRIC) as the basis for pricing. However, because of their numerous advantages, bill and keep arrangements should be permitted and States should be able to impose bill and keep methods on an interim or permanent basis.

The LECs should be able to place few restrictions on the resale of services. States should be able to determine the degree to which arbitrage between services is allowed to occur. Prices to resellers should reflect any promotional rates or discounts offered by the underlying carrier. The resale rules should recognize the anti-competitive potential of a LEC's ability to withdraw the offering of a service which is subject to resale.

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## I. Introduction

The Competition Policy Institute ("CPI") submits these comments on the Commission's Notice of Proposed Rulemaking in the Matter of the Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 ("Interconnection Rule"). CPI is a non-profit organization that advocates state and federal regulatory policies to bring competition to energy and telecommunications markets in ways that benefit consumers. We appreciate the opportunity to comment on the Commission's proposed Interconnection Rule.

As we will set out in these Comments, we think that the consumers' interest is best served by a national regulatory policy framework that leads to rapid growth in local exchange service competition. Local exchange competition will do for consumers what regulation has been able to do only imperfectly: stimulate the creation of new products and choices for consumers and constrain consumer prices for these services. The Telecommunications Act of 1996 ushers in a new era of telecommunications policy in which consumer needs will be met in a competitive market for all telecommunications services. The linchpin of this new regime is local exchange competition--the promise of the 1996 Act will not be delivered fully until consumers have choices for all telecommunications services, including basic local services.

In this rulemaking the Commission will adopt regulations concerning certain fundamental aspects of the relationships between today's monopolies and tomorrow's competitors. Federal and state regulators are faced with important basic choices at the outset of this new enterprise. The choices made in adopting these rules for interconnection, unbundling, and resale of incumbent LEC services will affect the speed and degree of development of the competitive market in local telecommunications. Indeed, when the Commission reads the comments in this proceeding, it should view them with the aid of one common denominator: how fast is local competition allowed to develop and how vibrant is it allowed to become?

The Competition Policy Institute favors an aggressive and activist approach to establishing local competition. In our view, the best result for consumers will occur if the incumbent LECs are faced with early and robust competition from a combination of facilities-based competitors, resellers, and competitors that purchase network elements from the LECs. The short history of local competition shows us that only through active regulatory intervention will the conditions for such competition occur.

There are consumer benefits to an aggressive and activist strategy. First, it limits the opportunity of the incumbent LECs to charge excessive rates to consumers. Early and vibrant competition will shrink the window in which incumbents are able to "rebalance" rates, by putting all customers, including residential customers, into competitive play. Second, it will hasten the time when the RBOCs are able to enter proscribed markets. This will offer consumers the benefits of more competitors in long distance service and, more importantly, change the incentives of the RBOCs in pricing local service. Third, introduction of competition at the earliest stage will improve customer choices and, if managed properly by regulators, improve the quality of services provided by today's local exchange monopolies.

We understand that there are implications in this strategy for the ability of the LECs to recover their historic costs. Our view is that competition will transform those old questions into new ones: instead of asking "What is the revenue requirement and how do I collect it?", LECs will begin to ask "What is the market price, how do I distinguish my product and lower my costs?" This will be the legacy of local competition.

In this docket, the Commission will undoubtedly hear about the virtues of setting prices at levels which permit the incumbent LECs to recover their historic costs. There will be arguments that the Commission should not enforce a consistent national approach to these competitive issues. Under the cloak of "states' rights" some LECs will be advocating a "go-slow" approach which is designed to retard the development of local competition. The Commission will probably hear that new entrants should have only limited access to unbundled features of existing LEC networks and that resale of service should be restricted in various ways.

Of course, all these arguments must be analyzed on their merits. But they must also be viewed as the sounds of an old system collapsing. CPI counsels that the Commission and the States should move as quickly as possible to enable local competition and to take steps to ensure that new entrants, provided they are willing to meet consumers' needs, can move quickly into a position to win market share from today's local exchange monopolies. It is essential that the Commission and the States stay the course of aggressive advocacy of local exchange competition.

The Federal Communications Commission is not alone in its efforts to foster local competition. Regulators in many states have been aggressively pursuing competition in their own jurisdictions. The efforts of the Commission will be diminished unless it seeks active collaboration with state regulators in implementing the new regime of local competition. A close partnership is required to realize the substantial advantages gained by the experience of State commissions that have been working in the trenches of deregulation and competition.

In these Comments, CPI will advocate that the Commission play a central role in implementing §251 at an early stage by adopting rules that decide some of the most fundamental issues of implementation. However, we ask that such preemptive action by the Commission go no farther than necessary to ensure that local competition is given a realistic opportunity to thrive. States have a vital and irreducible role in implementing the Telecommunications Act of 1996.

### A. The Telecommunications Act of 1996 Sets in Motion a Radical Change in the United States Telecommunications Industry and Its Regulation

Passage of the Telecommunications Act of 1996 marked the culmination of progress towards a fundamental change in telecommunications policy in this country. In the 1996 Act, Congress created a new paradigm for the provision of telecommunications services in the United States. A "pro-competitive, de-regulatory policy framework" will replace the system of regulated monopoly which had been the earlier paradigm.

The Act superseded the Federal Court's administration of an antitrust settlement which, heretofore, had been the single largest event in the development of competition in the telecommunications industry The Modification of Final Judgment was replaced with a new statutory scheme designed eventually to permit all telecommunications providers to compete in all markets. Following the opening of local markets and evidence of competition actually occurring, the Regional Bell Operating Companies are allowed to enter markets from which they have been barred since divestiture. The 1996 Act also amended provisions of the 1992 Cable Act, permitting today's large local exchange companies to enter the cable television business.

In addition, the 1996 Act ("pro-competitive") removed state legal and regulatory barriers which would prohibit, or have the effect of prohibiting, any entity from offering a telecommunications service. This means that local markets, previously closed to all but monopoly LECs, were now subject to competition. Finally, the Act ("de-regulatory") changed, or implied change, for the nature of regulation and the relationship between state and federal regulators.

But Congress apparently also knew that you cannot legislate the existence of true competition. Decades of law and regulatory practice had affirmed the correctness of the local exchange monopoly. The belief the local service was most efficiently provided by a monopoly is deeply ingrained in the legal system, in state laws and in the consciousness of today's local monopolies. Congress recognized that it was necessary to take strong, affirmative steps to make it possible for new entrants to gain a foothold in local exchange markets.

Thus Congress acted boldly to end monopoly control of local exchange telecommunications service. To ensure that new entrants were able to enter local markets in spite of the substantial market power of the incumbent local exchange companies, Congress fashioned requirements ("duties") for the LECs:

- Duty To Negotiate
- Interconnection
- Unbundled Access
- Resale
- Notice of Changes
- Collocation
- Number Portability

- DIALING PARITY
- ACCESS TO RIGHTS-OF-WAY
- RECIPROCAL COMPENSATION

Congress realized that the performance of each of these duties was necessary for the development of a competitive local exchange market. Since each of these duties is essential, it is not possible to rank the duties in terms of criticality. But it is clear that certain of the duties placed on the incumbent LECs present a threshold: unless new entrants are permitted to interconnect, resell, and purchase network elements local competition will not exist and the need for the other duties never arises.

It is instructive to compare the approach taken by Congress in the 1996 Act with the approach taken by the Court in the divestiture twelve years earlier. The Court imposed a structural change from *without*, separating "competitive" and "monopoly" services. While there certainly were duties imposed on the surviving local exchange providers (e.g., equal access) the Court was relying on a traditional antitrust technique: divestiture. Competition in the long distance industry was enabled by removing the opportunity for anti-competitive behavior. In the 1996 Act, the Congress is relying on two other techniques: imposing duties (e.g., access to monopoly network elements) and permitting today's monopolies to enter other markets (e.g., cable television and, eventually, interexchange service).

The duties imposed in the 1996 Act, especially the requirement to provide access to network elements and resale opportunities, will create competition and price pressures from *within*. In many ways, the approach in the 1996 Act can be as radical as divestiture in its effects, assuming the Commission follows through to make the availability and price of network elements and resale such that entry by competitors is economically rational and feasible. Making these elements available to competitors will inexorably lead to an elimination of the monopoly, with new entrants getting into the market and winning customers.

Thus, the unifying theme in this rulemaking must be this: competition in local communications will not develop without the active intervention of the state and federal regulators. Removing barriers to competition is only the first half of the solution. The second half is to create the conditions under which new entrants can gain market share from incumbents.

### B. The Consumers' Interest is Best Served by the Rapid Development of Robust Local Exchange Competition

By the time that the 1996 Act was signed into law, a majority of states had acted to remove barriers and to consider steps to enhance local competition. Many states have conducted proceedings to wrestle with some of the same fundamental issues announced in the Notice. The Commission is correct to have sought input from states in constructing the Notice.

Despite the efforts of state commissions and despite changes in technology and industry structure over the past decade, local exchange competition remains largely an abstraction. Twelve years after divestiture, new entrants in local telecommunications markets have achieved a negligible market share. In fact, the competitive access providers, enhanced service providers, and local exchange resellers have captured only a small fraction of the *growth* in revenues experienced by the local exchange industry. Few customers have a choice of local exchange provider and the field still belongs primarily to the traditional incumbent local exchange monopolies.

CPI suggests that the Commission and States should now act to protect consumers by implementing the §251 duties as quickly and fully as possible. We think that consumers' welfare is most at risk during the "transition to competition," when local competition is not sufficient to control prices, but during which state and federal regulation is also being severely tested. Indeed, delay works to the advantage of the incumbent local exchange companies in two ways: i) they are permitted to maintain rates based on inefficient historic investment decisions; and ii) the interval before they face competition is prolonged. For residential consumers, competition for all services is needed to thwart the prospect of rate "rebalancing" by the incumbents. To be specific, we believe that, if the Commission establishes rates for unbundled elements at levels which reflect Total Service Long Run Incremental Costs, most residential customers will have competitive choices at an early enough stage to prevent threatened cost shifting by the incumbent LECs.

There are two ways in which the Commission and the States can affect the pace of growth in local competition: i) ensuring the availability of unbundled network elements; and ii) setting the correct price for these network elements and resale options. CPI endorses the tentative conclusion of the Commission that "cost" should be interpreted to mean "economic cost" and that Total Service Long Run Incremental Cost is the appropriate cost standard to use. We further suggest that the use of a cost standard such as historic costs or embedded costs will retard the development of competition. If new entrants are required to reimburse the incumbent LEC for excessive historic costs (while these same LECs experience much lower incremental costs) entry will be delayed or denied. Further, the new entrants will face incorrect economic signals, causing them to overbuild existing systems instead of maximizing the use of the existing LEC network.

## II. The Commission Should Provide a Model for States to Use In Implementing the 1996 Act. The Model Should Specify Minimum Levels Of Unbundling and Interconnection and Set Broad Pricing Standards for the States.

Even a casual reading of the Telecommunications Act of 1996 reveals the compromises struck among various views on regulation vs. deregulation, state vs. federal jurisdiction and, private negotiations vs. regulatory control. The task which the Commission and the States face is to interpret the 1996 Act in a fashion that:

- serves consumers;
- is consistent with the plain language of the Act; and
- implements the purposes of the Act to be de-regulatory and pro-competitive.

Nowhere is this task more important (or difficult) than in the area of state/federal regulatory roles. We submit that the public interest is best served by an implementation plan which maximizes the role of the FCC and the States jointly.

We support the Commission's tentative conclusion to adopt a national policy framework for interconnection rules and pricing. The primacy of a national policy on these fundamental issues is consistent with §253(a) of the Act which preempts state laws and regulations which prohibit or have the effect of prohibiting an entity from offering any interstate or intrastate telecommunications service. Most of all, it serves consumers.

There are strong advantages to a national policy on core issues:

- A national policy on these core issues will speed the growth of local competition.
- A national policy will balance the bargaining strength in negotiations between existing LECs and new entrants.

- A national policy, properly constructed, will reduce the likelihood of consumers paying inflated prices.
- There will be a savings in costs of implementation including reduced litigation.
- National rules can be constructed to rely on states to interpret and implement.
- A national rule will aid many of the new entrants that will be launching national networks.
- A national rule will not prejudice small new competitive LECs.

As mentioned earlier, one of the evident tensions in the 1996 Act is between negotiation of interconnection agreements versus regulatory determinations. For that reason, the role of the States and the FCC to enforce pricing standards is not yet known. Depending upon the success of negotiations among new entrants and incumbent LECs, there will be more or less opportunity for the States (through arbitration) or the FCC (through its rules) to affect the terms of the agreements. Congress fashioned a compromise here: telecommunications providers are permitted to determine their own destiny unless they are unable to agree.

Through this tension, the 1996 Act invites the Commission and States to affect the negotiations by adopting rules such as those suggested in this Notice. Thus, we agree with the Commission's analysis in ¶20 that "...section 251 rules will tend to influence negotiations ... between incumbent LECs and requesting carriers seeking interconnection, access to unbundled network elements, and resale of LEC services. At least in some cases, the implementing Section 251 rules may serve as a de facto floor or set of minimum standards that guide the parties in the voluntary negotiations."

Some instances of the FCC's authority to adopt national rules is unambiguous: §251(d)(2) requires the FCC to determine the list of unbundled network elements. Elsewhere the FCC's authority is achieved and exercised indirectly, by adopting regulations under §251 which States must enforce in their role as arbitrators of negotiations between carriers. CPI supports the efforts of the Commission to forge a consistent regime: the Commission should set the general policy framework such as floors for unbundling and principles for resale and pricing of unbundled elements. The States, if called upon to arbitrate interconnection negotiations, would then apply these principles to the facts in their jurisdiction.

We suggested earlier that the Communications Act of 1996 has redefined the relationship between regulators and the industry and among regulators themselves. There are at least two areas where the State commissions have received additional authority under the 1996 Act: i) Section 252(b) gives state commissions the duty to arbitrate disagreements among interconnecting carriers and ii) Section 252(c)(2) requires State commissions to set the price of (unseparated) network elements and interconnection rates pursuant to arbitration.

This first change in authority is both a limitation and an expansion of state regulatory authority. State regulators have historically not been deeply involved in inter-carrier negotiations such as those between neighboring LECs or between wireless and wireline carriers. In many cases those agreements were not even filed with state commissions. Under the 1996 Act, States have received the duty to oversee disputes between *competing* LECs. This is a new responsibility for State commissions. The associated limitation, of course, is that state commissions *arbitrate* the areas of disagreement between new entrants and incumbent LECs and are not called upon to rule on agreements which are agreed to by the negotiating parties, unless the agreements are discriminatory or found not to be in the public interest. However, given the rivalry of the firms involved in negotiations and the size of this business issues at stake, it seems likely that there will be many issues brought to the State commissions for arbitration.

The second areas where state commissions have gained authority is in the pricing of (unseparated) network elements. Pursuant to its role as arbitrator, the state commission will set the price of network elements used both for intrastate **and** interstate services. In its Notice, the Commission opines that the 1996 Act does not contemplate the previous jurisdictional approach of "interstate" elements and "intrastate" elements. Instead, the Commission adopts the unified approach in which state commissions determine the cost of all elements subject to the over-arching pricing rules established by the FCC. We support the Commission's analysis on this point and find the resulting arrangement to be a consistent application of the Act.

## III. State Regulation and Improper Preemption in the Notice

The lines of relative responsibility and authority for State and Federal regulators to implement a new national policy framework for telecommunications are not always clear in the legislation. We have suggested that the FCC should establish a national regulatory model, determining the outcomes of the most basic elements of interconnection issues: the degree of unbundling and the method for pricing unbundled elements and resale. Following that direction from the FCC, state commissions must then discharge their responsibilities to ensure that interconnection negotiations reach a pro-competitive outcome. We think this is a reasonable interpretation and a reasonable implementation of the Act. The Commission's rules should be neither too prescriptive nor reach into areas of authority clearly reserved to the States.

There are several instances in the Notice where the Commission appears to consider improperly preempting legitimate state authority. The Commission requests comment on the preemption of authority in areas which are strictly, and properly, within the province of the States.

In ¶¶184-188 there is discussion about the connection between the prices of unbundled network elements and other prices, specifically local exchange rates. The Commission states in ¶188 that an incumbent LEC has suggested in another proceeding that the Commission commence a rulemaking to determine whether the Commission should preempt states, requiring states to set all rates above costs. In the Notice, the Commission seeks comments on whether the FCC should entertain this suggestion.

The Commission should not entertain the suggestion of the unnamed LEC. The Commission itself notes in ¶40 that "rates charged to end users for local exchange service, which have traditionally been subject to state authority, continue to be subject to state authority." It would be improper for the Commission to substitute its judgment for that of the State commission and set a floor for local rates.

On the merits of the issue, we doubt that there will be a large number of instances where retail prices are below the sum of TSLRIC costs for the elements. Of course, most of those instances will be high-cost rural areas where State commissions have determined to set prices below cost to keep rates affordable. (The discussion in ¶188 of the Notice does not seem to recognize this situation.) Further, rates in such circumstances are the subject of the Joint Board proceeding on Universal Service and of state universal service considerations. States are obligated to make subsidy flows "explicit" under §254 of the Act. The FCC should not consider usurping that role.

In ¶188, the Commission seeks comments on whether it should adopt interim rules on universal service funding before the Joint Board acts on these matters. Again, we suggest that it would be unwise (and contrary to the 1996 Act) for the FCC to take such an action prior to the action of the Joint Board. The 1996 Act is quite clear on the responsibility of the Commission to refer these matters to the Joint Board. These issues are imbued with a State interest to the degree that Congress felt it appropriate to create a Joint Board to consider them. The FCC should not consider preempting the actions of the Joint Board by adopting interim rules.

## IV. Unbundled Network Elements

### A. The Commission Should Specify in Rules a Minimum Set of Unbundled Network Elements Which The States May Expand.

The Commission's authority to specify which unbundled network elements should be made available to new entrants is clear. First, §251(c)(3) imposes the important duty on incumbent local exchange providers to make unbundled elements available:

> (3) Unbundled Access.--The duty to provide, to any requesting telecommunications carrier for the provision of a telecommunications service, nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms and conditions that are just, reasonable, and nondiscriminatory in accordance with the terms and conditions of the agreement and the requirements of this section and section 252. An incumbent local exchange carrier shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service.

The authority of the Commission to adopt rules to implement §251 generally, and the unbundling of elements specifically, is contained in §251(d)(1) and §251(d)(2):

(1) In General.-- Within 6 months after the date of enactment of the Telecommunications Act of 1996, the Commission shall complete all actions necessary to establish regulations to implement the requirements of this section.

(2) Access Standards.--In determining what network elements should be made available for purposes of subsection (c)(3), the Commission shall consider, at a minimum, whether-

(A) access to such network elements as are proprietary in nature is necessary and;

(B) the failure to provide access to such network elements would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer.

CPI agrees with the approach taken by the Commission in the Notice: the rules should encourage the maximum amount of local competition and efficient market entry by requiring that incumbent LECs offer access to all elements for which unbundling is technically feasible. Combined with the Commission's tentative conclusion that access to these elements should be priced at the Total Service Long Run Incremental Price, we think this regime presents the greatest likelihood that local competition will gain a foothold.

The presence of a minimum list of network elements which must be provided on an unbundled basis provides certain advantages to regulators and telecommunications providers:

- A list of minimum elements will likely produce a pro-competitive outcome in negotiations between carriers.
- A list of minimum elements will reduce variation between jurisdictions making it possible for carriers to plan national networks.
- A list of minimum elements will make it more feasible for a new entrant to fashion a network which uses parts of the existing LEC network.

We also think that this method affords the Commission and the States an opportunity to share responsibility for implementation. The Commission should adopt a minimum set of unbundled elements which States can expand. Incumbent LECs would have a duty to offer at least these individual elements, absent a showing of technical infeasibility or such issues as the existence of a threat to network reliability. In this regard, we support the Commission's tentative conclusion in ¶87 of the Notice that the burden of proving that access to an element is technically infeasible belongs to the providing LEC.

With this background, we endorse the following list of unbundled network elements:

- Loop Distribution (Portion of subscriber loop from network interface to loop concentrator)
- Loop Concentration Facilities (E.g., digital loop carrier equipment)
- Loop Feeder (Portion of loop from network concentrator to switch)
- Local Switching (including unbundled line and trunk ports)
- Common Transport (Trunk facilities switched at tandems connecting to carriers' POP)
- Dedicated Transport (Dedicated facilities from tandem to carriers' POP)
- Tandem Switching (Trunk-to-trunk switching for purposes of completing inter-switch calls)
- Operator Systems (Live or mechanized systems which provide customers with operator services such as intercept, directory assistance and call completion.)
- Signaling Links (Transmission facilities that carry out-of-band signaling traffic between end offices, tandem switches, signal transfer points and service control points.)
- Signal Transfer Points (A facility which connects signal links to transfer signals between elements of the signaling network.)
- Service Control Points (Node in the signaling network where requests for service handling, e.g., routing, are processed.)
- Databases adequate for use in billing and collection.

From our review of action in state commissions, we believe that access to these network elements is both technically feasible and necessary for new entrants to enter local markets. We note that this list is similar to rules recently adopted by the Colorado Public Utilities Commission pursuant to Colorado's new competition statute and similar to lists developed in other states. This list differs from the Colorado rules by including sub-elements of the loop and by explicitly including access to billing and collection databases access.

**B. The Commission Should Specify in Its Rules the Meaning of "Cost" for Unbundled Network Elements Which The States Determine and Apply in Arbitration.**

The 1996 Act requires, in Section 252(c), that an interconnection agreement arbitrated by a State Commission shall meet the requirements of Section 251, including rules established by the FCC, and shall contain rates for network elements which are just and reasonable. In determining whether rates are just and reasonable, the State commission is directed by Section 252(d)(1):

> (1) Interconnection and Network Element Charges.-- Determinations by a State commission of the just and reasonable rate for the interconnection of facilities and equipment for purposes of subsection (c)(2) of Section 251, and the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section--
> (A) shall be--
> (I) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable), and
> (ii) nondiscriminatory, and
> (B) may include a reasonable profit

In ¶117 of the Notice the Commission concludes that it has the authority to adopt rules on pricing. CPI believes that the Commission, as a matter of policy, should adopt the basic principles of availability and pricing to be applied by the States. The advantages of this regime are clear:

- entry by competitors will be hastened.
- negotiations among carriers will likely come to a speedier termination.
- all participants will avoid unneeded litigation over the most fundamental aspects of the new competitive paradigm.

### C. The Price for Unbundled Network Elements Should Be Based on Total Service Long Run Incremental Costs (TSLRIC)

In promulgating its rule in this docket, the Commission has determined to interpret the notion of "cost" in §252(d)(1)(A)(I) to mean "economic cost". We agree with this interpretation of the 1996 Act and agree further TSLRIC pricing is appropriate to encourage competition.

TSLRIC pricing offers numerous advantages:

- TSLRIC prices will induce new entrants to make the economically correct decision between building facilities or purchasing LEC facilities.
- Providing access to network elements at TSLRIC prices will begin to "discipline" LEC prices by exposing them to competition by other providers.
- TSLRIC pricing is pro-competitive, preventing price squeezes and keeping competition between new entrant and incumbent fair.

We expect that the Commission will be asked by some of the ILECs to base the price of unbundled network elements on historic embedded costs, "the costs we experienced building the network." There are several reasons this would be inappropriate:

- LECs themselves do not face these costs when they add a customer.
- It would be unfair to charge competitors a higher cost than that faced by the incumbent LEC.

- Prices based on embedded costs will not be efficient.
- Charging rates based on embedded costs forces a competitor potentially to subsidize the inefficient behavior of the incumbent LEC.

The Commission should remain resolute in its decision to interpret the 1996 Act to require that the unbundled network elements be based on economic costs.

In ¶128 ff. in the Notice the Commission discusses the issue of the recovery of overhead costs and joint and common costs. CPI favors allowing the price of unbundled network elements to include the overhead expenses based on a proxy of the overheads attributable to an efficient firm. A recent study of the pricing of network elements, conducted by Hatfield Associates, Inc., suggests that such an overhead loading would be approximately six percent.[1]

CPI also considers it appropriate to include in the price of network elements a reasonable allocation of the joint and common costs shared in the production of those elements. We understand, however, that the methodology which derives the TSLRIC of network *elements* does not identify large joint and common costs compared to the application of TSLRIC to *services*. The logic of this observation is easy to grasp: a network element (such as local switching) does not require the use of the loop for its provision, so that a portion of the loop would not be assigned to local switching. This is true even though the cost of the loop is a major shared cost category for many services. In the other direction, the TSLRIC of the loop would already include the cost of the loop itself (again, usually a major shared cost). For that reason, we are not concerned about the effect on efficiency caused by allocating these joint and common costs in setting the price for these elements based on TSLRIC.

[1]"The Cost of Basic Network Elements: Theory, Modeling and Policy Implications," March 1996, Hatfield Associates, Inc., page 30.

Finally, we suggest that it is not appropriate to collect universal service support costs by adding them to the cost of network elements. In our view, it is very unlikely that this method will be competitively neutral. In the Joint Board proceeding, we have endorsed the use of an external universal service fund which is assigned to all telecommunications providers on the basis of net telecommunications revenues. This is a superior method for collecting these costs, whether in an intrastate or interstate jurisdiction.

In its Notice the Commission solicited commenters to provide definitions of some "cost" terms:

***Shared costs*** are joint and common costs.

***Joint costs*** are those costs incurred to produce multiple products when the products are produced in a fixed ratio to each other.

***Common costs*** are costs incurred to produce multiple products when the products are not produced in a fixed ratio to each other.

***Overhead costs*** are those costs which are shared by all products of a firm: "the president's desk."

***Long Run Incremental Costs*** are the costs of an additional increment of output when all inputs are allowed to vary.

***Total Service Long Run Incremental Costs*** is the additional (incremental) cost of producing an entire service, measured by allowing all inputs to vary. It is sometimes described as the difference in total cost of a firm's operations with and without the production of a given service, using forward-looking costs.

***Embedded Costs*** are historic accounting costs.

## V. Interconnection

### A. The FCC Should Specify in Rules a Minimum Set of Points of Interconnection Which States May Expand.

The 1996 Act recognizes that local competition cannot survive, or even begin to grow, until the networks of new entrants can connect to established LEC networks. This requires that new entrants are assured of non-discriminatory interconnection with the networks of incumbent LECs. The 1996 Act imposes this duty on incumbent LECs:

> (2) Interconnection.--The duty to provide, for the facilities and equipment of any requesting telecommunications carrier, interconnection with the local exchange carrier's network--
>
> (A) for the transmission and routing of telephone exchange service and exchange access;
>
> (B) at any technically feasible point within the carrier's network;
>
> (C) that is at least equal in quality to that provided by the local exchange carrier to itself or to any subsidiary, affiliate, or any other party to which the carrier provides interconnection; and
>
> (D) on rates, terms and conditions that are just, reasonable, and nondiscriminatory, in accordance with the terms and conditions of the agreement and the requirements of this section and section 252.

CPI supports the tentative conclusion of the Commission to establish a minimum list of points of interconnection which should be used by the States in arbitrating failed interconnection negotiations. The Commission's list should be a floor, capable of being expanded by State commissions. Further, the Commission should periodically revise the minimum list as appropriate to changes in technology. We also agree that the burden should be on incumbent LEC to show that a proposed point of interconnection is not feasible.

CPI supports at least the following points of interconnection:

- Network Interface
- Loop Concentrator
- Line Side of Switch
- Trunk Side of Switch
- Tandem Switches
- Signaling Links
- Signal Transfer Points
- Signal Control Points
- Operator Services

### B. The Commission Should Require That the Price of Traffic Termination be Based on TSLRIC Costs. The Rule Should Clarify That States Can Order Bill and Keep Arrangements on an Interim or Permanent Basis

The Commission should require the use of TSLRIC pricing for traffic termination for the same reasons given for its use in pricing unbundled network elements. In particular, the Commission should not permit incumbent LECs (or new entrants) to use historic accounting costs to derive the price for traffic termination.

Since billing for traffic termination will be bilateral, the focus may properly be on the difference between revenue flows between two carriers. Under two assumptions, I) that traffic is relatively balanced between two carriers, and ii) that similar firms will have similar TSLRIC costs for